

**COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

**RESPONSE OF THE ATTORNEY GENERAL TO THE
FIRST SET OF INFORMATION REQUESTS FROM
BAY STATE GAS COMPANY
D.T.E. 05-27**

Dated: August 2, 2005

Responsible Party: Timothy Newhard

BSG-AG-1-16 Please refer to the Newhard Testimony at page 1, lines 3-4. Please state whether Mr. Newhard accepts the Company's proposed capital structure ratios of 46.05% long-term debt and 53.95% common equity for the purpose of this case. If Mr. Newhard does not accept these ratios, please provide a statement of the capital structure ratios that he would accept, along with all supporting documentation, workpapers and source documents.

Response: Mr. Newhard accepts the calculations used to determine the Company's proposed adjusted test year end capital structure may be mathematically correct. He does not believe, however, that the calculated long-term debt ratio is appropriate for determining base rates for the Company's distribution services, since that debt ratio is obviously artificial and significantly lower than that required of a more economic capital structure. The Company's capital structure is artificial, since its parent company holds essentially all of its outstanding equity and debt. A more economic capital structure would have the debt ratio between 55 and 65 percent rather than 45 percent, as the Company proposes.

A higher debt ratio is supported by (1) financial theory which provides for, up to a point, decreasing overall weighted costs of capital with increasing amounts of leverage, (2) the addition of short-term debt to the Company's capital structure, since short-term debt has become a significant and permanent source of funding for the Company, representing on average \$186 million or 32 percent of the capital structure of the Company, including short-term debt (see Attachment 1), and (3) investment analysts which will rate distribution companies with debt ratios between 55 and 65 percent in the investment grade bond ratings of BBB to A (see Attachment 2, page 3).

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BSG-AG-1-17 Please refer to the Newhard Testimony at page 1, lines 3-4. Please state whether Mr. Newhard accepts the Company's proposed cost of debt (i.e., 6.18% as adjusted to reflect the actual cost of the pro forma debt issues) for the purpose of this case. If Mr. Newhard does not accept this cost rate, please provide a statement of the cost of debt that he would accept, along with all supporting documentation, workpapers and source documents.

Response: Mr. Newhard accepts the calculations performed to determine the proposed cost of debt may be mathematically correct. He does not believe, however, that the contracted for cost of debt is necessarily the appropriate cost for each series, since the Company could not show that on the days on which it issued certain of its debt series that the stated "coupon rates" for each series were at or below the market rate for that type of debt. For instance, when the Company was asked in Exhibit AG-10-19 to show proof that its coupon rate on its 5.40% notes due March 21, 2013 was the lowest possible for the terms of the debt instrument, it failed to do so. Equally, the Company failed to provide such evidence in Exhibit AG-10-20 for its 5.58% notes due December 20, 2019 and in Exhibit AG-10-21 for its 5.94% notes due December 20, 2024. As a result, for the majority of its outstanding long-term debt which is issued to its affiliate NiSource Finance, the Company has no proof that the coupon rates were the lowest possible rates given their terms that it could have achieved on the date of issue. Therefore, given the potential for self-dealing with regard to these issuances and the fact that the NiSource Finance had the incentive to profit at the cost of Bay State customers, there is no proof that the bonds were issued at the lowest cost.

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BSG-AG-1-18 Please refer to the Newhard Testimony at page 2, lines 9-11. Please provide a list of all cases (jurisdiction, docket no., company, year) in which Mr. Newhard has presented testimony before the Department. For those cases where the subject matter of the testimony involved the cost of equity, please provide a full and complete copy of that testimony appended as an Attachment to this response

Response: Mr. Newhard provided testimony before the Department in the following cases:

Boston Edison Company, D.P.U. 906
Blackstone Gas Company, D.P.U. 1130
Boston Edison Company, D.P.U. 1350
AT&T Communications of New England, D.P.U. 85-136/85-137
New England Telephone and Telegraph, D.P.U. 86-33-G
Nantucket Electric Company, D.P.U. 88-161/168
Generic Proceeding on Manufactured Gas Cleanup Costs, D.P.U. 89-161 D.P.U. 85-136/85-137
New England Telephone and Telegraph, D.P.U. 86-33-G
Nantucket Electric Company, D.P.U. 88-161/168
Generic Proceeding on Manufactured Gas Cleanup Costs, D.P.U. 89-161
Bay State Gas Company, D.P.U. 94-16
Boston Edison Company, D.T.E. 98-118/98-119/98-126
Fitchburg Gas & Electric Light Company, D.T.E. 99-66
Bay State Gas Company, D.T.E. 01-81
Boston Gas Company, D.T.E. 03-40

Attached are testimonies where Mr. Newhard has provided cost of equity testimony before the Department.

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BSG-AG-1-19 Please refer to the Newhard Testimony at page 2, line 9-11. Please indicate whether Mr. Newhard has ever presented testimony before a regulatory agency or governmental body other than the Department or its predecessor. If so, please provide a full and complete copy of that testimony appended as an Attachment to this response

Response: Mr. Newhard has provided testimony in the forms of affidavits and depositions before other government agencies regarding various regulatory issues during his career. He does not have copies of those documents. To the best of his recollection, the topic of the cost of equity for a gas utility company was not the subject of any of those testimonies.

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BSG-AG-1-20 Please refer to the Newhard Testimony at page 4, lines 15-16. Please provide a citation to each Department Order that finds that a parent company's cost of equity is an acceptable measure of a subsidiary utility's rate of return.

Response: The Department has found it acceptable to use the parent company's cost of equity to measure a utility's cost of capital in the following cases:

Boston Gas Company, D.T.E. 03-40, pp. 329-330 and pp. 355-356.
Fitchburg Gas & Electric Light Company, D.T.E. 02-24/25, pp. 214-215 and pp. 225 –226.
Fitchburg Gas & Electric Light Company, D.T.E. 99-118, p. 65 and pp. 80-82.
New England Telephone and Telegraph, d/b/a NYNEX, D.P.U. 94-50, pp. 477-478.

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BSG-AG-1-21 Please refer to the Newhard Testimony at page 4, lines 19-25. Please provide a historical breakdown of the business segments of NiSource covering the years 2000 - 2004 showing, (i) the dollar amount and (ii) percent to total of (iii) revenues, (iv) operating income, and (v) identifiable assets for its (vi) gas distribution business, (vii) its gas transmission and storage business, (viii) its electric business, (ix) its unregulated businesses, and (x) its other businesses. Please provide associated workpapers in electronic form with all protection, if any, removed from the spreadsheet and all formulas intact, and source documents

Response: The Company has all of this information readily available to itself, since NiSource generates all of that information internally. Notwithstanding that fact, the Attorney General provides Attachment 1 derived from the 2004 10-K for the years 2002-2004 that shows the breakdown of financial and operational information for NiSource's different business segments. Comparable data was not available for 2000 and 2001.

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BSG-AG-1-22 Please refer to the Newhard Testimony at page 4, lines 19-25. Please provide an analysis showing any revenues derived from (i) the gas distribution business, (ii) the gas transmission and storage business, and (iii) the electric business that are derived by NiSource from non-regulated sources.

Response: According to the business strategy discussion section of NiSource's 10-K, "NiSource focuses its business strategy on its core rates-regulated businesses with virtually 100 percent of its operating income generated from the rate regulated businesses." See the attachment which is page 4 from the Company's 2004 Form 10-K filed with the Securities and Exchange Commission.

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BSG-AG-1-23 Please refer to the Newhard Testimony at page 8, lines 2-3. Please provide any studies performed by Mr. Newhard, or are known to him, that establishes “The twelve-month average incorporates a historical period that investors commonly use to evaluate stocks.” Please provide the workpapers and source documents for Mr. Newhard’s studies and a copy of any studies prepared by others

Response: Mr. Newhard has not performed a specific study of investors. Rather, he relies on his general observations of the twelve-month measures often cited in fundamental and technical investment reports as the basis for investment analysis and recommendations.

The best example of the use of twelve months of price information is found in the *Wall Street Journal* that includes in its daily reports for stocks such statistics as the high and low stock price for the last year, as well as price-earnings ratios, and dividend yields from the previous twelve months. See the Attachment 1.

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BSG-AG-1-24 Please refer to the Newhard Testimony at page 8, lines 18-19. Please provide all studies prepared by Mr. Newhard, or known to him, that establishes the practice of averaging overlapping periods consisting of six-month and twelve-month average dividend yields. Please provide the workpapers and supporting source documents for these studies.

Response: The averaging of dividend yields to determine a proxy dividend yield for the Discounted Cash Flow analysis is standard practice in regulatory proceedings to estimate the dividend yield. The average yield is used by the Department, the Federal Energy Regulatory Commission, and the Company's cost of equity witness in this proceeding. Ultimately, averaging the six- and twelve-month yields simply gives three-quarters weight to the most recent six months and one-quarter weight to the previous six months in determining the dividend yield to be used in the DCF model.

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BSG-AG-1-25 Please refer to the Newhard Testimony at page 15, lines 3-4. Please provide the electronic spreadsheet in Microsoft Excel of the iterative model used to solve the two-step DCF. Please remove all protection, if any, from the spreadsheet and leave all formulas intact

Response: Please see the attached spreadsheet.

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BSG-AG-1-26 Please refer to the Newhard Testimony at page 15, line 21. Please specifying (sic) the date of the issue of Blue Chip Financial Forecast and provide a complete copy of that publication.

Response: The date of the *Blue Chip* issue is June 2005 which was provided by the Company in its response to AG-10-6 and attached hereto.

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BSG-AG-1-27 Please refer to the Newhard Testimony at page 16, lines 3-4. Please specify time periods associated with the inflation rate and real growth rate in the GDP. Please provide a copy of the source documents that were utilized for these figures

Response: The time period associated with the long run rates are those found in the June 2005 *Blue Chip Financial Forecasts*, page 36, Consensus forecasts for the period 2007 through 2011 and 2012 through 2016. See the Attachment to the response to BSG-AG-1-26.

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BSG-AG-1-28 Please refer to the Newhard Testimony at page 16, lines 9-10. Please provide an electronic copy of the workpapers used to compute the 9.21 percent return. Please remove all protection, if any, from the spreadsheet and leave all formulas intact.

Response: Please see the spreadsheet attached to the response to BSG-AG-1-25.

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BSG-AG-1-29 Please refer to the Newhard Testimony at page 16, line 21 through page 17 line 1. Please identify for each company in Mr. Newhard's Comparison Group the (i) dollar amount and (ii) percentage of (iii) revenues, (iv) operating income, and (v) identifiable assets committed to (vi) unregulated natural gas marketing and sales service and (vii) power generation. Please provide all workpapers and source documents.

Response: The Attachment provides the information for the companies in Mr. Newhard's comparison group.

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BSG-AG-1-30 Please refer to the Newhard Testimony at page 17, lines 1-3. Please provide any studies performed by Mr. Newhard, or known to him, that establishes the non-utility businesses of the Comparison Group have greater business risk. Please provide all workpapers and source documents for these studies

Response: The higher risk associated with these non-regulated businesses as compared to the regulated distribution business is generally understood in the investment community. Examples of the recognition of the higher risk can be found in the attached Standard & Poor's document which indicates the lowest risk -- averaging a 2 to 3 Business Profile Score, for distribution and transmission companies as found in Chart 2 on page 5, a higher risk of approximately 5 for integrated companies as shown on Chart 4 on page 7, a higher risk for Diversified Energy of 5 to 6 for diversified Energy companies as shown on Chart 5, and the highest business risk profile for Energy Merchant/ Developers / Trading and Marketing which center around 9 out of a possible 10. *Value Line Investment Survey* which is Attachment 2 also speaks specifically to the higher risk of these businesses within the gas distribution companies' parent company:

“There is great deal of diversity in constituents of this industry. The biggest differences are usually seen with nonregulated business segments. As companies shift toward these businesses, they increase the potential for capital appreciation and risk of capital loss. Moreover, companies making a concerted push to nonregulated businesses may be less generous with dividend increases, preferring to use money to build new ventures rather than pay it out to shareholders. Investors should pay close attention to this factor when making commitments here.”

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BSG-AG-1-31 Please refer to the Newhard Testimony at page 17, lines 1-3. Please (i) define and (ii) describe the market structure for the non-utility businesses for each company in Mr. Newhard's Comparison Group

Response: The gas and power marketing businesses have gone through tremendous changes as a result of the California energy crisis and the Enron bankruptcy. Furthermore, the deregulation of the electric generation business, along with bankruptcies and changing regulation has caused tremendous uncertainty in this business as well.

In both cases, investors have come to recognize the higher risk of their investments by requiring higher returns.

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BSG-AG-1-32 Please refer to the Newhard Testimony at page 17 lines 1-3. Please identify the identity of the competitors, and all factors that would cause changes in market structures for the non-utility business for each company in Mr. Newhard's Comparison Group

Response: For the marketing companies, the competitors would be all those in the gas and power marketing businesses both national and in their respective regions. For the generation companies, the competitors would be the same with national as well as within their respective regions.

The factors that would cause changes in the market structure would include such things as national and local economic conditions, state and federal market regulation, and local and national competition.

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BSG-AG-1-33 Please refer to the Newhard Testimony at page 17, lines 7-8. For each of the base rate adjustments in the Company's standard fixed base rate revenues: (i) describe the adjustment, (ii) quantify the amount of revenues derived by the Company over each of the past five years for that adjustment, (iii) quantify the net income impact for each of the past five years if the adjustment did not exist, and (iv) quantify the change in the variability of net income over the past five years with and without the adjustments.

Response: The additional base rate adjustments refer to those newly proposed by the Company in this case and therefore, they would not affect the Company's revenues in the last five years.

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BSG-AG-1-34 Please refer to the Newhard Testimony at page 17, line 21. Please provide the workpapers showing the development of the “85 percent” figure.

Response: Please see the attached spreadsheet.

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BSG-AG-1-35 Please refer to the Newhard Testimony at Page 18, line 2. Please quantify in numerical terms the impact on the cost of equity for the dramatic reduction in investment risk. In doing so, assign a numerical value to each adjustment clause in effect or proposed by the Company. Please provide all workpapers and source documents

Response: The reduction in risk should put the Bay State Gas Company at the lowest end of the range in terms of the cost of equity, since no other gas distribution company has all of these adjustments that provide the extent of the cost recovery that the Company proposes here.

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BSG-AG-1-36 Please refer to the Newhard Testimony at page 18, lines 12-13. Please provide the workpapers in electronic form for the “7.77 percent” and “9.49 percent” figures. Please remove all protection, if any, from the spreadsheets and leave all formulas intact. Also please provide copies of all source documents

Response: Please see the spreadsheet attached to the response to BSG-AG-1-25.

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BSG-AG-1-37 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 1.
Please provide a copy of the source documents for this schedule.

Response: The information for Schedule 1 was derived from internet website pages
and other publications.

S&P Stock Ranking: BusinessWeek online – See attached

S&P Business Profile S&P Financial Guidelines Revised – See
Attachment 1 to the response to BSG-AG-
1-30

ValueLine Stock
Price Stability ValueLine Investment Survey – See
Attachment to response to BSG-AG-1-41

Bond Rating S&P Financial Guidelines Revised – See
Attachment 1 to the response to BSG-AG-
1-30 and Moody's

Long-Term Debt Ratio BusinessWeek online, page 4 of the report
for each company – See Attachment to
response to BSG-AG-1-46.

Interest Coverage Utility COMPUSTAT from Exh. AG-10-
15.

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BSG-AG-1-38 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 1. Please provide an electronic copy of this schedule. Please remove all protection, if any, from the spreadsheets and leave all formulas intact.

Response: There were no spreadsheets used to calculate or manipulate the data shown on Schedule 1. Everything was entered as text.

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BSG-AG-1-39 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 2.
Please provide a copy of the source documents for this schedule.

Response: Please see the attached.

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BSG-AG-1-40 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 2. Please provide an electronic copy of this schedule. Please remove all protection, if any, from the spreadsheets and leave all formulas intact

Response: Please see the spreadsheet attached to the response to BSG-AG-1-25.

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BSG-AG-1-41 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 2.
Please provide a copy of the source documents for the dividends shown
monthly.

Response: Please see the attached.

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BSG-AG-1-42 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 3.
Please provide a copy of the source documents for this schedule.

Response: Please see the attachment to the response to BSG-AG-1-41.

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BSG-AG-1-43 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 3. Please provide an electronic copy of this schedule. Please remove all protection, if any, from the spreadsheets and leave all formulas intact

Response: Please see the spreadsheet attached to the response to BSG-AG-1-25.

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BSG-AG-1-44 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 4.
Please provide a copy of the source documents for this schedule.

Response: Please see the attachment to the response to BSG-AG-1-41.

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BSG-AG-1-45 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 4. Please provide an electronic copy of this schedule. Please remove all protection, if any, from the spreadsheets and leave all formulas intact

Response: Please see the spreadsheet attached to the response to BSG-AG-1-25.

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BSG-AG-1-46 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 5.
Please provide a copy of the source documents for this schedule.

Response: The information for Schedule 5 was derived from internet website pages
at *Netscape Money & Business* and *BusinessWeek Online*. Please see the
attached. The Zack's Survey Forecast is found on page three of each
BusinessWeek Online document, under the section "Current EPS
Estimates," on the line "Next 5 Year Growth (%).

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BSG-AG-1-47 Please refer to the Newhard Testimony at Mr. Newhard's Schedule 5. Please provide an electronic copy of this schedule. Please remove all protection, if any, from the spreadsheets and leave all formulas intact

Response: Please see the spreadsheet attached to the response to BSG-AG-1-25.